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CAR TRUSTS

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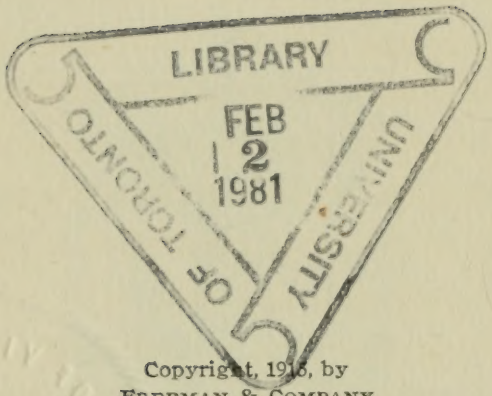

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Introduction

It has been established that to the remarkable industrial progress of the United States there has been no more important contributory feature than that of the splendid work accomplished by the American Railroads. The building of the Railroads has meant literally the building of a prosperous nation and there is perhaps nothing more inspiring or indicative of the swift revolution of our wheels of commerce than the spectacle of a modern railway locomotive, huge yet graceful, as it draws a long train of all steel cars at a high rate of speed over lines of well ballasted rails. To the observer, it must be evident that the tremendous growth of the Railroads in this country has been at least comparatively measured by the exceptional improvement in the kind of equipment in use, and the purpose of this booklet is to bring to the attention of the reader interesting facts concerning the different types of modern rolling stock now being operated over the various roads, together with a short description of the method of financing the purchase of such equipment under what is usually termed a Railroad Equipment Trust.

History of Car Trusts

A report of the American Bar Association states that in 1845 certain barges were purchased by the Schuykill Navigation Co. on deferred payment under the terms of conditional sale. This appears to be the earliest record of the use of what has been evolutionized into the modern car trust. In the early 70's one or two railroads in a rather weakened financial condition resorted to the car trust agreement in order to obtain new rolling stock, and about 1873 the method of purchasing railroad equipment by deferred payment for use on American railway systems was first actually put into effect. The car trust, however, speedily commended itself to far-seeing managers who were quick to appreciate the opportunity to enlarge the carrying capacity of their railroads. In a comparatively few years Equipment Bonds were issued by all important systems. The past twenty-five years have witnessed a wonderful increase in the amount of car trust obligations outstanding. In 1890, according to figures furnished by the railroads, there were approximately $49,000,000 of Equipment Bonds outstanding. By 1900 this total had increased to $60,000,000. A noteworthy growth was

recorded during the next three years, for in 1903 figures derived from the same source showed that $142,000,000 were in the hands of the public and in 1905 this total had been raised to approximately $200,000,000.

The Pennsylvania Lines which, in 1890, had outstanding about $15,000,000 worth of equipment notes increased their car trust indebtedness during the next fifteen years to $50,000,000. In like manner the equipment obligations of the bituminous roads increased from $1,500,000 to $14,500,000, and the total car trusts of anthracite roads jumped from $2,000,000 to $17,000,000.

In June, 1910, figures furnished by the Interstate Commerce Commission showed that there were outstanding approximately $350,000,000 car trusts, and it is estimated that the total amount of equipment obligations now outstanding is between $500,000,000 and $600,000,000.

The Agreement

In drawing up an equipment agreement the Trustee strives for absolute security. Car trusts are issued under what is legally a lease or an agreement of conditional sale. The reason becomes apparent when it is noted that in some States of the Union it is extremely difficult, in the event of a receivership, for a third party to recover under a true sale. Then, again, the possible use of an "after acquired" clause in an old mortgage covering any property to be acquired in the future, makes a true sale impracticable. Therefore the form of lease or conditional sale is used. It is usually understood that a true sale is an intent to convey ownership. A lease, in the strict sense of the word, simply permits the use of certain properties for a stipulated length of time, while a conditional sale is a sale subject to certain restrictions. Car trust securities are issued under a standard form of indenture, the validity of which has been fully tested by law. The interests of the investor are most carefully protected. The equipment is accurately described, the numbers of the various cars, engines, etc., are noted. The total cost of the equipment

and the amount of original cash payment made by the Railroad Company is also stated.

In the agreement of conditional sale, title to the equipment remains in a third party and does not pass to the Railroad Company until the last installment of notes has been paid.

When the form of lease is used, full legal title to the equipment is absolutely vested in the Trustee for the benefit of the bondholders and conditions governing the lease are specifically set down. We quote a few of the principal clauses in the ordinary indenture:

"Until payment by the Railroad Company of all equipment notes and coupons thereto attached, and until all of the obligations of the Railroad Company hereunder shall have been fully complied with and performed, the title to said trust equipment shall not pass to nor vest in the Railroad Company, but shall remain in the Trustee, its successors or assigns, for the equal benefit of the holders of the equipment notes, notwithstanding the delivery to and the possession and use of the said trust equipment by the Railroad Company."

"The Railroad Company shall and will at all times keep all of said trust equipment, and any equipment that may be used to replace any part thereof, in proper order and complete repair."

"The Railroad Company shall and will, during the term of this Indenture, keep said trust equipment, and all equipment used to replace any part thereof, insured in insurance companies of good standing, against loss or damage by fire and against other loss or damage."

"The Railroad Company shall not cause or permit any of such trust equipment to be pledged or held for any taxes, debts or obligations of the Railroad Company or to be in any manner encumbered by or through it."

"In case the Railroad Company shall make default in the payment of any part of the sums herein provided to be paid by it * * * the Trustee may retake the trust equipment, and every part thereof, including all substitutions therein and additions thereto, wherever the same may be found and may require the Railroad Company forthwith to deliver the trust equipment to the Trustee at any point which the Trustee may designate."

The agreement should be properly recorded in the state or states in which the railroad operates. Copies of the indenture governing any equipment trust may usually be obtained upon application to the Trustee.

The Philadelphia Plan

Car Trust Securities are also issued under what is known as "The Philadelphia Plan." Under this method of financing, an equipment trust is created by agreement between a Trust Company, one or more designated individuals, and the Railroad Company. The actual equipment is purchased by the Equipment Trust, and share certificates, usually in denomination of one thousand dollars each and entitling the holder to fixed dividends, are issued against the equipment by the Trust Company as Trustee. These certificates, as in all plans, run from ten to fifteen years and mature in equal amounts annually, semi-annually or quarterly, as the case may be. Title to the equipment is absolutely vested in the Trust Company as Trustee for the benefit of the shareholders until the entire issue has been paid. The equipment is leased by the Trustee to the Railroad Company at an annual rental sufficient to meet the dividend requirements and to pay the maturing shares as they come due. Equipment certificates issued under this arrangement are unconditionally guaranteed as to payment of face value and dividends by the Railroad Company. The "Philadelphia Plan" fully protects the

security holder and owing to certain benefits which are held to accrue to the holders of car trusts issued under the "Philadelphia Plan," these certificates enjoy great popularity especially in the State of Pennsylvania.

Factors of Safety

After it has been determined that the equipment trust agreement has been well and carefully drawn, the next most important factor to be scrutinized is the collateral underlying the trust. Under present day conditions this should consist of standard steel or steel under-frame cars or modern locomotives of good heavy type and high tractive power.

Of almost equal importance is the amount of the cash payment. If the cash payment is at least fifteen per cent. (15%) and if the equipment is standard and has been purchased at fair prices, it is safe to assume that the security of the bondholder will at all times be unimpaired, providing, of course, that the various conditions nominated in the agreement are properly fulfilled.

Owing to the record for safety possessed by railroad equipment bonds, it has been the practice among institutions and investors, however, to accept an equipment obligation as safe when the original cash payment is smaller than 15%, provided the credit of the issuing road is strong and that the indenture governing the trust has been correctly drawn.

As a rule, it does not require much effort on the part of the buyer to satisfactorily calculate the equity in any equipment trust, if the actual condition and original value of the equipment pledged is known. To obtain this it is necessary to have the amount of the original cash payment and the total amount of notes matured; also, a report showing the condition of the equipment, together with a schedule of the replacements and repairs, should be obtained from the Trustee. Depreciation, according to the figures furnished by the Master Car Builders Association, may be figured on the basis of 5% annually for steel or steel underframe and 6% for wooden car bodies.

Duties of the Trustee

In order to properly identify the property, the Trustee should always be in possession of a complete schedule of the equipment, giving car and locomotive numbers and full specifications, name of builder and other important information. Such information should be accurately set forth in the indenture.

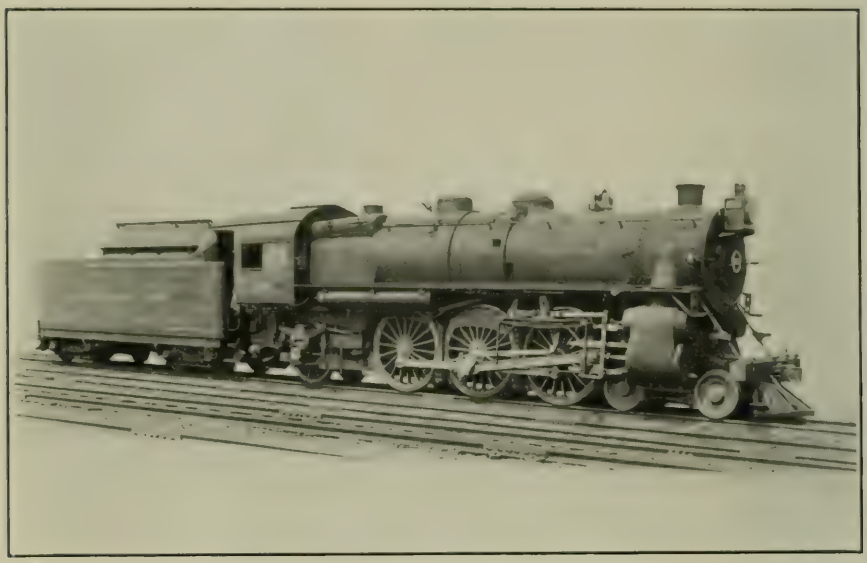
If the Trustee will co-operate with the bankers in obtaining a satisfactory indenture, and if the Railroad Company be required to make, from time to time, accurate reports concerning the condition of the equipment, the question of security is practically settled for the noteholder. It is imperative that the Railroad Company be required to keep cars which are pledged under its various equipment trusts in proper repair. Roads in financial difficulties, which instead of repairing equipment pledged under previous trusts make a practice of buying new equipment through the sale of additional equipment notes, succeed only in weakening their credit.

Various methods are followed by Trust Companies in determining the condition of the rolling

stock pledged under a trust of which they are Trustee.

Periodical reports to be received from the Railroad Companies at definite intervals seems to be the best way of keeping in touch with the condition of the rolling stock, and it is also helpful in finding out whether or not the Railroad Companies are living up to the various conditions set forth in the indenture.

The proper and legal vesting of the title to the equipment in the Trustee or third party is most important. It is also necessary to insure against the title to the equipment passing to the Railroad Company, in order to obviate any legal difficulty should foreclosure be found advisable.



PACIFIC TYPE LOCOMOTIVE

TRIPLE ARTICULATED MALLET LOCOMOTIVE

Locomotives

Improvement and rapid development have been more marked in the case of railroad locomotives than in any other type of rolling stock. In accordance with a movement to obtain the greatest amount of hauling force at the least possible expenditure, managers of leading railroads have been ordering locomotives of increased size until now engines capable of exercising an enormous drawbar pull and developing horsepower of over 3,000 have been built and are in active operation. Freight locomotives in use on the Virginian Railway are among the largest locomotives in service. These huge locomotives encounter a grade of .6% in moving trains of from 6,000 to 7,500 tons. The Erie Railroad operates a giant locomotive of recent construction which is known as the triple articulated Mallet. This engine possesses tractive power of 160,000 lbs., combining three powerful and separate sets of drivers. A distinct departure is involved in the construction of this monster locomotive, the tender being used as the third unit and carrying a complete group of driving wheels.

The Mallet Engine is the most efficient type of

present day locomotive which is used for hauling freight, locomotives of this type handling freight trains over a mile in length. The first engine of this sort ever built in this country was constructed at Schenectady for the Baltimore & Ohio Railroad Company in 1904. The increase in weight in locomotives is most remarkable. In 1835 the first bridge for carrying railroad locomotives was constructed to bear the weight of a four wheel engine weighing less than eleven tons. In 1873 a maximum weight of 100,000 lbs. was reached and in 1905 this figure had jumped to 200,000 lbs. The total weight of the Erie Triplex Mallet Engine is 853,050 lbs.

The Consolidation, Mikado, Pacific and Mountain are among the other types of modern locomotives in use. Pacific locomotives are termed the "Greyhounds of the Rails." This type of engine is in service on all of the larger systems to draw the fastest through passenger trains.

Steam locomotive development of the future will, in all probability, continue to bring out increased power through changes in design and more economical use of fuel.

ELECTRIC LOCOMOTIVE

MIKADO TYPE LOCOMOTIVE

Electric Locomotives

There has been a decided increase within the past two years in the number of electric locomotives manufactured by the several companies engaged in this line of business. These locomotives of standard design are quite acceptable as collateral under equipment trusts and the cost compares favorably with that of steam locomotives. The electric locomotives possess some advantages over steam locomotives such as greater efficiency in cold weather and independence of water and fuel.

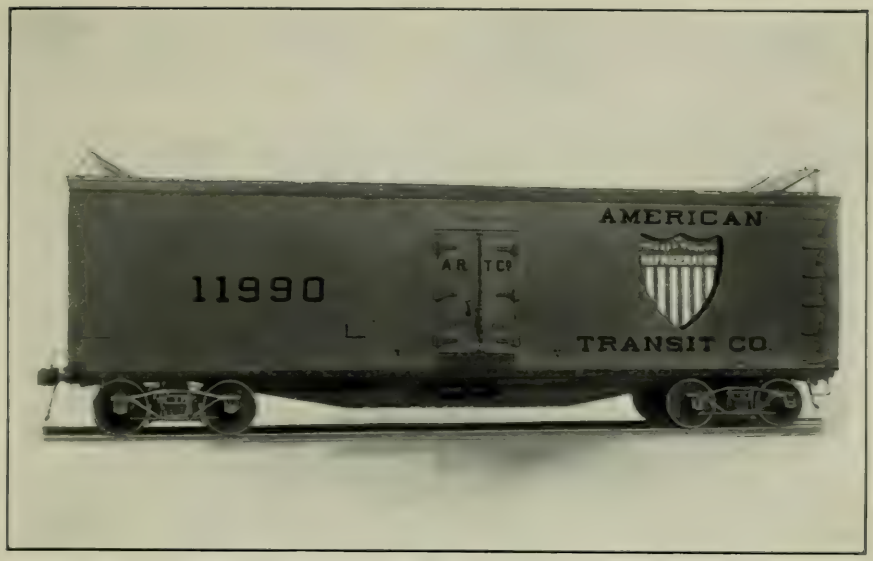
Locomotives of this type weigh from 50 to 150 tons. On the Norfolk & Western Railway there are, at present, electric locomotives in operation of 11,000 voltage. These locomotives weigh 135 tons and haul heavy freight trains of approximately 3,000 tons over steep mountain grades. In the electric zones of the Pennsylvania and New Haven Railroads many modern electric locomotives are now in use.

Cars

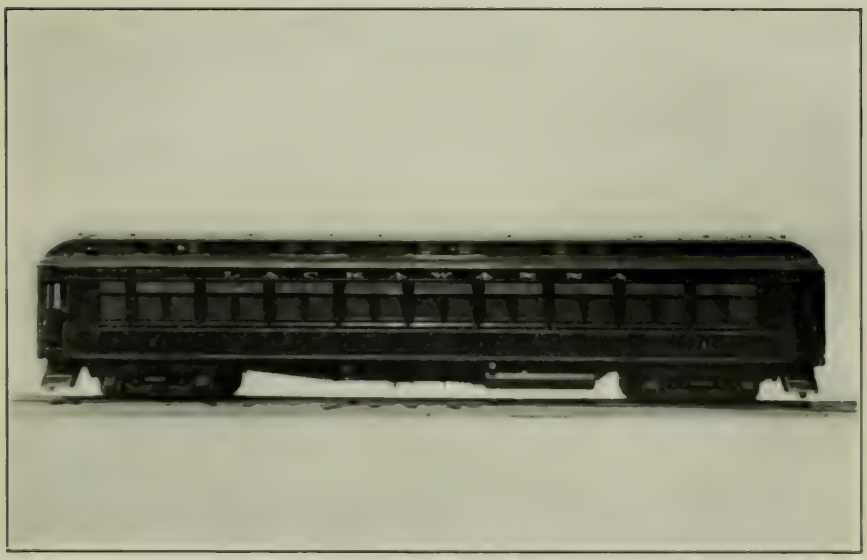
In the early days of railroading, the traveler rode without much complaint in stunted and dingy wooden cars where smoking oil lamps vied with penetrating soot and cinders from a soft coal or wood burning locomotive in contriving to make the interior of the coach almost unbearable. From these pioneer cars with small square windows and cramped uncomfortable seats has been evolved the modern passenger coach with its electrically lighted and well heated interior, its expensive upholstery and its staunch steel construction.

The results of railroad collisions involving wooden and steel cars in destructive impact, have strongly influenced public sentiment in favor of passenger trains of all steel construction and the recommendations of various commissions appointed to inquire into the causes of such accidents have tended greatly to increase the percentage of all-steel cars.

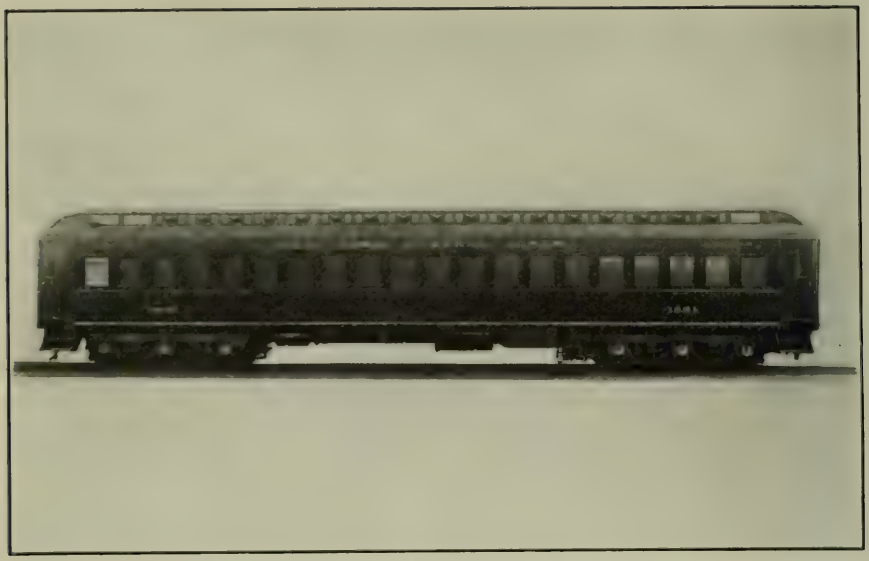
However, of the kinds of equipment pledged under a majority of the car trusts now outstanding, freight cars of various types predominate. Box, flat, automobile, coal, ore and other varieties of cars for the conveyance of merchandise, minerals



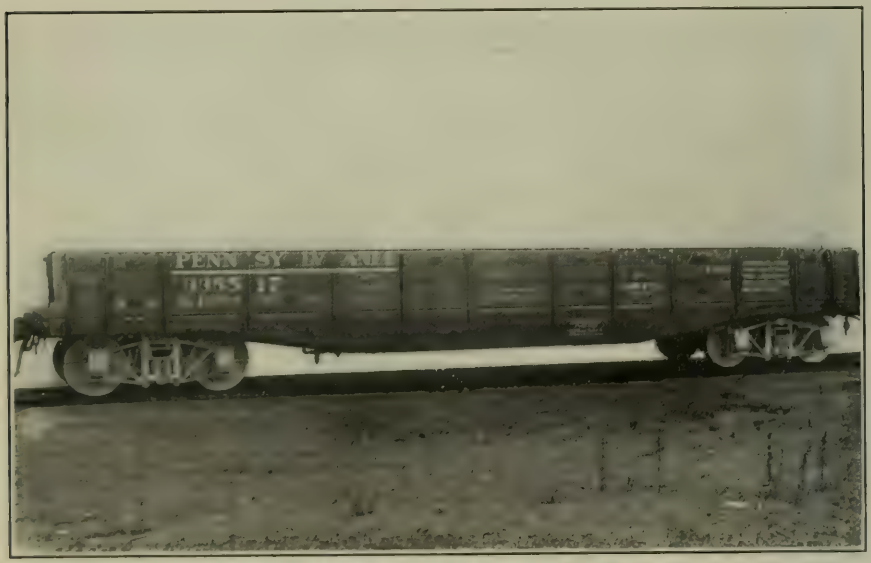
REFRIGERATOR CAR



ALL STEEL PASSENGER COACH



ALL STEEL PASSENGER COACH



STEEL UNDERFRAME GONDOLA

and different commodities are operated in large numbers.

Figures recently gathered show that, of the total of 80,000 freight cars ordered during a definite period by the Railroads of the United States, Canada and Mexico, over 70,000 were of all-steel or steel underframe construction, while the number of wooden cars ordered was but 4,000 or about 5%. Of this total, steel underframe box cars numbered over 25,000 and all-steel gondola cars over 15,000. Of the total of 2,000 passenger cars ordered during the same period all but 234 were specified as being of all-steel construction or as having steel underframes, and practically 75% of these passenger cars were lighted by electricity.

A recent equipment order typical of the kind of freight cars in use on leading roads included 4,000 steel underframe box cars and 600 all-steel automobile cars. The automobile cars were of 100,000 lbs. capacity and possessed a capacity of 4,630 cubic feet. The box cars were built with steel underframes, steel end construction, and steel roofs, giving practically the same protection as that afforded by the all-steel cars.

Box cars built with steel underframes cost very

little for maintenance, as repairs are confined principally to trucks, wheels and couplers. This, of course, does not take into consideration damages which may arise from wrecks, although it is true that in the case of steel or steel underframe cars, reconstruction is comparatively easy even after the car has been through a disastrous collision.

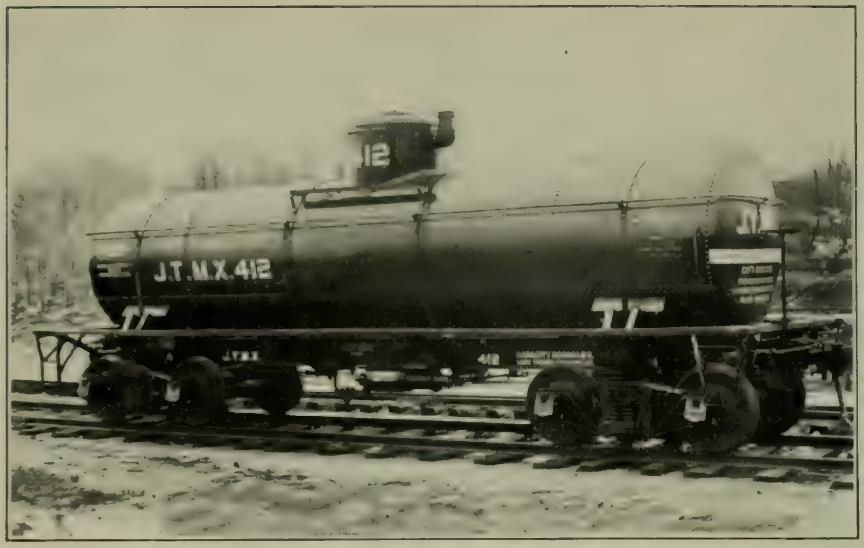
There are a number of advocates among Railroad Managers in the interest of the construction of a standard steel underframe box car and a resolution is before the Master Car Builders Association recommending the adoption of a standard frame and standard inside dimensions for such box cars.

In looking over the orders given recently for new equipment, it is especially noticeable that there has been a large increase in the number of new refrigerator cars ordered. The transportation of perishable freight has become one of the most important parts of the general freight business and some railroads run fast freight trains on approximately the same speed schedule as that carried out by the through passenger trains.

In 1888 less than 300 refrigerator cars were in service along the Pacific Coast. This number has been increased until it is now well over 30,000.

ALL STEEL HOPPER CAR

STEEL UNDERFRAME BOX CAR



ALL STEEL TANK CAR

ALL STEEL GENERAL SERVICE CAR

The tremendous growth of the oil industry in this country has greatly stimulated the buying of tank cars. These cars are perhaps more standard in design than any other type of freight equipment, and, owing to their long life, make acceptable collateral for equipment notes. It is estimated that the life of a steel tank car is over twenty years and cars built twenty-five years ago are still in active service.

In cutting down equipment maintenance expenses and reducing the number of cars destroyed annually, the recent improvements in air brakes have played a considerable part. Modern air brakes operating pneumatically and under electric control have demonstrated that while traveling at a speed of sixty miles an hour it is possible to stop within its own length a train 1,000 feet long weighing 1,000 tons and consisting of twelve all-steel passenger cars.

Under these improvements, the full braking power of the train is exerted within two seconds after the engineer turns his lever.

Marketability of Car Trusts

A striking evidence of the strong market position occupied by railroad equipment bonds was furnished during the disturbance in the securities markets following the outbreak of the European War in August 1914. In order to safeguard the financial structure of the country, it became necessary to prohibit open buying and selling of securities of maturities of longer than one year, except under stringent restrictions. These restrictions included a definite minimum price under which it was agreed no transactions were to be permitted. A careful examination of the situation, however, convinced the Committee of Bankers under whose jurisdiction limited trading was being carried on, that unrestricted transactions in railroad equipment securities could safely be allowed. A rule was accordingly published permitting open trading in all car trust securities of any maturity and from that time on prices of such securities advanced steadily. It is a matter of record that during the period of financial anxiety following the outbreak of the war, there was comparatively no selling of railroad equipment bonds at low prices, while there existed

at all times an actual market upon which such securities could have been sold had any holder so desired.

Equipment bonds, always in demand from the larger Banks, Trust Companies and Insurance Companies, are becoming more popular every day with the directors of the smaller banking institutions throughout the country. The sound principles upon which bonds of this sort are issued and their many other advantages, including their quick convertibility into cash, are rapidly being recognized by all classes of investors and this increasing demand has greatly broadened the market for these bonds.

To the small investor, car trust securities are very attractive. In no other form of security can the man who has only two or three thousand dollars to invest obtain so high an interest yield with such a corresponding degree of safety of principal, while short maturities of railroad equipment bonds form an advantageous "time money proposition."

The record of car trust securities for prompt payment of principal and interest during good times and during periods of depression has been exceptional. Rolling stock is essential to the

operation of any railroad and in modern railroading sharp competition for both freight and passenger business has rendered imperative the maintenance of adequate facilities for handling traffic. A study of railroad receivership proceedings extending back over thirty years proves that in the event of receivership the position of the equipment noteholders is stronger than that of the holders of any other class of security. The collateral under equipment notes is so tangible and the agreement covering the collateral has such legal strength that the holders of car trust securities are in a position to demand prompt payment of principal and interest.

We buy and sell entire issues of car trust securities and endeavor at all times to offer a comprehensive assortment of this class of bond. The facilities of our statistical department are always at the service of our customers and upon request, we shall be pleased to furnish a complete description of any equipment trust.

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